

Message Text

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ACTION EB-04

INFO OCT-01 SS-14 ISO-00 EUR-03 TRSE-00 SP-02 INR-05

CIAE-00 NSAE-00 OMB-01 NSC-05 L-01 IO-06 /042 W

-----081727 221100Z /23

R 220901Z MAR 78

FM AMEMBASSY LISBON

TO SECSTATE WASHDC 5145

C O N F I D E N T I A L SECTION 1 OF 2 LISBON 2110

LIMDIS

DEPT. PASS TREASURY FOR SYVRUD

E.O. 11652: XGDS-3

TAGS: EFIN, ECON, PO

SUBJECT: PORTUGAL'S FOREIGN DEBT SERVICING CAUSING CONCERN

SUMMARY: PORTUGAL'S FOREIGN DEBT/RESERVE RELATIONSHIPS ARE RAISING TROUBLING QUESTIONS. EFFECTIVE AVAILABLE RESERVES ARE LIMITED TO BANK OF PORTUGAL FREE GOLD HOLDINGS, WHICH CURRENTLY TOTAL SOME \$2.3 BILLION AT MARKET PRICES. THE TOTAL EXTERNAL DEFICIT, EXCLUDING GOLD SECURED LOANS, REACHED APPROXIMATELY \$2.9 - \$3 BILLION AT THE END OF 1977. DEBT SERVICING CHARGES THIS YEAR WILL BE EQUAL TO ABOUT 37 PERCENT OF 1977 MERCHANDISE EXPORTS AND 19 PERCENT OF CURRENT ACCOUNT GROSS RECEIPTS. A GOP FAILURE TO REDUCE THE EXTERNAL DEFICIT SUBSTANTIALLY AND CONVINCINGLY COULD LEAD TO A RAPID EXHAUSTION OF RESERVES. THESE DATA HIGHLIGHT THE IMPORTANCE OF AN EFFECTIVE STABILIZATION PROGRAM. END SUMMARY.

1. RESERVES: PORTUGAL'S INTERNATIONAL RESERVES, EXCLUDING PRIVATE HOARDING AND INDUSTRIAL GOLD, CONSISTS OF TREASURY AND COMMERCIAL BANK FOREIGN EXCHANGE BALANCES, AND THE BANK OF PORTUGAL (BP) LIQUID RESERVES AND GOLD HOLDINGS. TREASURY AND COMMERCIAL BANK ASSETS ARE BASICALLY OPERA-
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TING BALANCES AND, AS SUCH, ARE AVAILABLE TO THE GOVERNMENT ONLY IN EXTREME SITUATIONS. BP LIQUID RESERVES, CURRENTLY ABOUT \$300 MILLION, WERE GENERATED BY GOLD SALES AND GOLD SECURED LOANS. ALTHOUGH MOST OF THESE LIQUID ASSETS WOULD BECOME AVAILABLE DURING AN EXCHANGE CRISIS, BP BELIEVES IT MUST MAINTAIN APPROXIMATELY THIS LEVEL IN ORDER TO OPERATE COMFORTABLY. IN THE LAST ANALYSIS, THEREFORE, THE NATION'S

READILY DISPOSABLE RESERVES ARE LIMITED TO THE BP GOLD STOCKS.

2. THESE GOLD STOCKS HAVE FALLEN SIGNIFICANTLY SINCE THE END OF 1976. AT THAT TIME THEY TOTALED JUST OVER 860 TONS WHICH, AT A MARKET PRICE OF \$134 PER OUNCE, WERE WORTH ABOUT \$3.7 BILLION. SINCE THEN, BP HAS DISPOSED OF SOME 110 TONS, WHICH PROBABLY PROVIDED LIQUID ASSETS OF SOMEWHAT MORE THAN \$500 MILLION. GIVEN THE INCREASING PRICE OF GOLD, THE DOLLAR VALUE OF THE GOLD HOLDINGS HAS ACTUALLY RISEN RATHER THAN DECLINED. AT PRESENT, BP REMAINING GOLD ASSETS OF 750 TONS ARE WORTH ABOUT \$4.3 BILLION, GIVEN A MARKET SALES PRICE OF \$178 PER OUNCE. NOT ALL OF THIS GOLD, HOWEVER, IS AVAILABLE. ALMOST \$2 BILLION, INCLUDING A GENEROUS SAFETY MARGIN, IS PLEDGED AS SECURITY, LEAVING ABOUT \$2.3 BILLION IN FREE GOLD. ONE MUST INCLUDE TOTAL GOLD HOLDINGS AND TOTAL DEBTS, OR CANCEL OUT BOTH THE GOLD SECURED DEBT AND THE GOLD USED AS SECURITY, IN ORDER TO APPRAISE THE EXTERNAL SECTOR PROPERLY. IN ANY CASE, PORTUGAL'S RESERVE POSITION IS RAISING TROUBLESOME QUESTIONS.

3. FOREIGN DEBT: FOR THE FIRST TIME DECADES, PORTUGAL'S FOREIGN DEBT EXCEEDS ITS GROSS INTERNATIONAL RESERVES OF SOME \$4.8 BILLION (4.3 B/P GOLD, 0.3 B/P LIQUID RESERVES, APPROXIMATELY 0.2 FOR TREASURY AND COMMERCIAL BANK

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ASSETS. RECORDED FOREIGN DEBT DURING 1977 ROSE BY \$1.6 BILLION, FROM \$3 BILLION TO \$4.6 BILLION. THESE FIGURES DO NOT INCLUDE CREDITS OF LESS THAN 90 DAYS, I.E., MOSTLY SUPPLIER CREDITS, UNLESS THEY WERE CHANNLED THROUGH A BANKING INSTITUTION. IF THESE VERY SHORT-TERM CREDITS HAD BEEN INCLUDED, THE DEBT FIGURE AT THE END OF 1977 PROBABLY WOULD HAVE TOTALED 4.9 - \$5 BILLION.

4. THE INFLOW OF CAPITAL LAST YEAR EQUALLED A VERY HIGH PERCENTAGE OF THE DOMESTIC ECONOMY. IF ONE ADDS 1977 GOLD SALES, THE INCREASE IN THE RECORDED DEBT AND PRESUMING AN INCREASE IN VERY SHORT-TERM OBLIGATIONS OF AT LEAST SOME \$100 MILLION (WITHOUT TAKING ACCOUNT OF SUCH ITEMS AS DIRECT INVESTMENT AND CHANGES IN COMMERCIAL BANK FOREIGN ASSETS), THE GROSS FINANCIAL INFLOW PROBABLY SURPASSED \$2.1 BILLION. THIS FIGURE EQUALLED ALMOST 13 PERCENT OF THE OFFICIAL GDP ESTIMATE; 51 PERCENT OF TOTAL 1977 INVESTMENT, AND 63 PERCENT OF 1977 FIXED INVESTMENT. THESE PERCENTAGES INDICATE CLEARLY THAT PORTUGAL'S EXTERNAL FINANCIAL DEPENDENCY IS GREATER THAN SUGGESTED BY ITS BASIC EXTERNAL DEFICIT, AND EXCEEDS WHAT THE PRESENT ECONOMY COULD HOPE TO SUPPORT OVER THE MEDIUM TERM.

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ACTION EB-04

INFO OCT-01 SS-14 ISO-00 EUR-08 TRSE-00 SP-02 INR-05
CIAE-00 NSAE-00 OMB-01 NSC-05 L-01 IO-06 /047 W
-----081999 221058Z /23

R 220901Z MAR 78
FM AMEMBASSY LISBON
TO SECSTATE WASHDC 5146

C O N F I D E N T I A L SECTION 2 OF 2 LISBON 2110

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5. FOLLOWING TABLE TRACES GROWTH OF PORTUGAL'S FOREIGN
DEBT OVER THE PAST SEVERAL YEARS.

PORTUGAL'S EXTERNAL DEBT (END OF THE YEAR)				
BILLIONS OF ESCUDOS		BILLIONS OF DOLLARS		
1977	1975	1976	1977	
GOVERNMENT DEBT	11.0	0.2	0.3	0.3
DEBT GUARANTEED BY THE STATE	34.6	0.4	0.6	0.9
BANK OF PORTUGAL DEBT	66.2	0.4	1.2	1.7
DEBT WITHOUT GOVERNMENT GUARANTEE	67.3	0.6	0.9	1.7
TOTAL	179.1	1.6	3.0	4.6

6. DEBT SERVICING: THIS RAPID ACCUMULATION OF DEBT HAS
INCREASED SHARPLY THE ANNUAL COST OF FOREIGN DEBT SERVICING.
BANK OF PORTUGAL DATA INDICATE THAT TOTAL SERVICING COSTS
IN 1978 ARE SCHEDULED AT \$1,766 MILLION. IT EXPECTS TO
ROLL-OVER SLIGHTLY MORE THAN ONE BILLION DOLLARS OF
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AMORTIZATION PAYMENTS DUE ON THE GOLD SECURED LOANS. THUS, TOTAL SERVICING COSTS ARE MORE LIKELY TO APPROACH \$750 MILLION. EVEN SO, THIS FIGURE REPRESENTS APPROXIMATELY 37 PERCENT OF PORTUGAL'S 1977 MERCHANDISE EXPORTS AND 19 PERCENT OF ITS CURRENT ACCOUNT GROSS RECEIPTS. FOLLOWING TABLE LISTS PROJECTED FOREIGN DEBT SERVICING COSTS THROUGH 1983.

SERVICE OF PORTUGAL(S EXTERNAL DEBT
(AS OF DECEMBER 31, 1977)
(MILLIONS OF DOLLARS)

	1978	1979	1980	1981	1982	1983
1. BANK OF PORTUGAL						
DEBT	1,202	171	196	103	99	15
INTEREST	57	32	29	18	14	3
AMORTIZATION	1,145	139	167	85	85	12
2. OTHER DEBT						
INTEREST	92	83	78	52	47	32
AMORTIZATION	472	209	180	167	151	114
3. TOTAL						
INTEREST	149	115	107	70	61	35
AMORTIZATION	1,617	348	347	252	236	126

7. CONCLUSION: FOREGOING HIGHLIGHTS PORTUGAL'S DIFFICULT EXTERNAL POSITION. BANK OF PORTUGAL HAS, BETWEEN ITS FREE GOLD AND LIQUID ASSETS, RESERVES OF SOME \$2.6 BILLION. UNLESS GOP POLICIES IMMEDIATELY REDUCE THE EXTERNAL DEFICIT AND REFURBISH THE FOREIGN SECTOR'S FALTERING CONFIDENCE, THESE RESERVES COULD EVAPORATE QUICKLY. IF BANKERS AND EXPORTERS LOSE THEIR CONFIDENCE, THEY UNDOUBTEDLY WOULD ELIMINATE OR PRECIPITIOUSLY REDUCE THEIR SHORT-TERM CREDITS TO PORTUGAL. IF THEY DREW DOWN ALL SUCH CREDITS, WHICH NOW EXCEED \$1 BILLION, PORTUGAL'S FREE RESERVES WOULD TEND TO FALL TOWARD \$1.6 BILLION. EVEN IF ONE

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PRESUMES THAT THE GOP WOULD THEN INTRODUCE VARIOUS EXCHANGE CONTROLS TO REDUCE LOSSES, THE BALANCE OF PAYMENTS DEFICIT WOULD BE LARGE ENOUGH TO WIPE OUT THOSE ECONOMIC REFORMS. SUCH A SCENARIO WOULD CERTAINLY BE UNACCEPTABLE. IT INDICATES THAT GOP HAS LITTLE CHOICE BUT TO AVOID SUCH A DOWNWARD SPIRAL, AND PART OF THE ALTERNATIVE, PREVENTIVE POLICY MUST INCLUDE AN IMF AGREEMENT; IN ORDER TO ESTABLISH EXTERNAL CONFIDENCE. BLOOMFIELD

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FINANCIAL STABILITY, GOVERNMENT DEBTS
Control Number: n/a
Copy: SINGLE
Draft Date: 22 mar 1978
Decaption Date: 20 Mar 2014
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978LISBON02110
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: X3
Errors: N/A
Expiration:
Film Number: D780126-0035
Format: TEL
From: LISBON
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780338/aaaabfxn.tel
Line Count: 219
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 8664c1bf-c288-dd11-92da-001cc4696bcc
Office: ACTION EB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: LIMDIS
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 31 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3241166
Secure: OPEN
Status: NATIVE
Subject: PORTUGAL'S FOREIGN DEBT SERVICING CAUSING CONCERN SUMMARY: PORTUGAL'S FOREIGN DEBT/RESERVE RELATIONSHIPS ARE RAISING TROUBLING QUESTIONS. EFFECTIVE AVAILABLE
TAGS: EFIN, ECON, PGOV, PO
To: STATE
Type: TE
vdkgvkey: odbc://SAS/SAS.dbo.SAS_Docs/8664c1bf-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014